

**REPORT OF EXAMINATION**  
**Fraternal Beneficial Association**  
**As of December 31, 2000**



**Fraternal Beneficial Association**

**CHIEF EXAMINER'S AFFIDAVIT**

I certify that I have reviewed the Report of the Financial Examination of Fraternal Beneficial Association of Spokane, Washington, as of December 31, 2000.

Patrick McNaughton  
Chief Examiner

## Fraternal Beneficial Association

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May 3, 2002

Honorable Mike Kriedler, Commissioner  
Washington Office of the Insurance Commissioner  
Capital 5000 Building  
PO Box 40255  
Olympia, Washington 98504-0255

Dear Commissioner:

Pursuant to your instructions and in compliance with the requirements of the state of Washington, an examination has been made of the corporate affairs and financial records of:

Fraternal Beneficial Association  
of  
Spokane, Washington

hereafter referred to as the "Association" or "FBA" at its home office located at 12414 E. 26th Ave., Spokane, WA 99216. The following report is respectfully submitted.

#### **SCOPE OF EXAMINATION**

Our examination included a review of the business affairs and financial condition of the Association for the five year period ended December 31, 2000. The examination was performed in accordance with procedures promulgated by the National Association of Insurance Commissioners (NAIC) and in compliance with the provisions of Washington state insurance laws and regulations.

## **INSTRUCTIONS**

### **1. Brokerage Accounts**

The Association has certificates of deposit and government bonds in the custody of the brokerage firms D.A. Davidson and Solomon Smith Barney. The Association's use of these brokerage firms as custodian of its certificates of deposit and bonds is in violation of RCW 48.13.450(6) which states a "'Qualified custodian' means either a participating financial institution or a clearing corporation, or both. A qualified custodian does not include a broker."

**The company is instructed to remove these assets from the brokerage firms and place them in an authorized custodial method as defined pursuant RCW 48.13.460, which states the only authorized methods of holding securities are the following:**

- (1) A domestic insurance company may hold securities in definitive certificates;**
- (2) A domestic insurance company may, pursuant to an agreement, designate a participating financial institution or institutions as its custodian through which it can transact and maintain book-entry securities on behalf of the insurance company; or**
- (3) A domestic insurance company may, pursuant to an agreement, participate in depository systems of clearing corporations directly or through a custodian bank.**

### **2. Policy Limits**

The Association's ability to raise policy limits is governed by RCW 48.11.140 which states, "No insurer shall retain any risk on any one subject of insurance, whether located or to be performed in this state or elsewhere, in an amount exceeding ten percent of its surplus to policyholders."

Review of the inforce listing indicated two policies over the \$200,000 limit in which premiums were charged at appropriate amounts for the over \$200,000 face values. Linda Cupp, the Association's Secretary-Treasurer, indicated that each of these two policies had two buildings and should have separate policies which would be under the limit. The appraisers are reviewing the policies and plan to issue four separate policies.

In several cases, multiple policies issued in aggregate to the same policy holder were in total over the \$200,000 limit. Linda Cupp, Secretary-Treasurer, indicated the appraisers verify each policy is a unique and an individual risk, i.e. if one building burns it would not ignite another insured risk. If the policies are on outbuildings of the same farm, it seems reasonable to assume a crop or other type fire may burn multiple insured buildings.

**The Association is instructed to review all policies as indicated above to verify and document in the policy files the safeguards in place or the proximity of buildings which eliminate the possibility of multiple claims by any one policyholder under one event or fire.**

## **COMMENTS AND RECOMMENDATIONS**

## **1. Check Signing Authority**

Our examination disclosed the Association does not have limits or dual signatory controls in place for signing and issuing checks for claims, investment purchases and general expenses.

**It is recommended the Association implement signatory controls which require dual signatures on all checks written for ten thousand dollars or more. This would ensure the review of all material disbursements by two authorized officers of the Association and enhance cash controls. During the course of our examination, the Association's Board approved the dual signatory requirement. It is recommended the Association notify all financial institutions and to make appropriate revisions to the signature cards and check stock.**

## **HISTORY**

The Association was originally organized under the name of Unterstutzungs Verein von Spokane and Whitman Counties (literally translated: German Mutual Assistance Association of Spokane and Whitman Counties) in 1891 as a fraternal mutual property insurer organization. The name was changed in 1918 to Fraternal Beneficial Association. The original certificate of authority was issued by the Washington State Insurance Commissioner in 1918 to transact the business of insurance as a fraternal mutual property insurer. To date, the Association only offers fire protection property coverage. The Association primarily sells to farmers in Eastern Washington.

## **MANAGEMENT AND CONTROL**

The constitution and bylaws of the Association vest the management and control of the affairs of the Association in an Executive Committee consisting of a president, first vice president, second vice president, secretary-treasurer and assistant secretary-treasurer. In addition, the governing documents require the president to appoint two members who with the five elected officers shall constitute an executive committee. All officers must be members of the Association and are elected annually at the June meeting by ballot of the members.

### **Officers and Appointees as of December 31, 2000:**

<u>Name</u>	<u>Position</u>
Joe Schmitz	President
Sharon McCoy	First Vice President
David Buob	Second Vice President
Linda Cupp	Secretary-Treasurer
Marty Fisher	Asst. Secretary-Treasurer

Lawrence D. Baumgartner  
Tom Solbrack

Appointee  
Appointee

**Concentration of ownership:**

There are approximately 500 shareholders as of December 31, 2000. To become a shareholder, members must have applied and been accepted as a policyholder. Prospective members must be farmers and have the potential of producing five hundred dollars or more of agricultural crops that could be sold. Shares are not actively traded and each stockholder has an ownership interest in an amount equal to the face value of his/her policy.

**CORPORATE RECORDS**

Review of the minutes of the Executive Committee, Annual Shareholders and Appraiser's meetings were conducted for the five years under examination. Two changes were made to the corporate bylaws and constitution. In June of 1997, article 6c was changed to set the minimum emergency reserve fund at \$1,500,000. In June of 1999, article 14c was changed to increase maximum policy limits to \$175,000. In June of 2001, article 14c was again changed to increase maximum policy limits to \$200,000.

The Association's ability to raise policy limits is governed by RCW 48.11.140 which states, "No insurer shall retain any risk on any one subject of insurance, whether located or to be performed in this state or elsewhere, in an amount exceeding 10 percent of its surplus to policyholders."

**CONFLICT OF INTEREST**

The Association's policy concerning conflict of interest was found to be appropriate. No conflicts were disclosed for the period of our examination.

**INTERNAL SECURITY**

**Fidelity Insurance:**

The Association is the named insured on a fidelity bond issued by the Reliance Insurance Group. The coverage is a \$100,000 dollar fidelity bond on the officers of the Association. This exceeds the minimum suggested by the National Association of Insurance Commissioners of \$25,000 for a company of this size.

**Internal Controls:**

The Association contracts all of its accounting and policy service functions to L. C. Accounting

Service (the Service) which is owned and operated by Linda Cupp, the Association's Secretary-Treasurer. The Service supplied documentation on the controls in place for receipts, disbursements and investments. The controls were reviewed for appropriateness and adequacy. The review determined that the controls were minimal due to lack of division of duties. Linda Cupp essentially runs the entire operation. Due to this control environment, minimal reliance was placed on the controls and the Association agreed to have an annual review of the accounts and records by the President to add an additional check and balance to the operations.

### **EMPLOYEE WELFARE AND PENSION PLANS**

The Association does not have any paid employees and therefore, does not offer a pension plan or any other employee welfare plans.

### **TERRITORY AND PLAN OF OPERATIONS**

The Association is organized and authorized to transact the business of property insurance in the state of Washington. The Association's business is conducted under an assessment premium plan. The principal place of business is in Spokane, Washington. The Association provides fire and smoke damage insurance to its members who are primarily farmers of eastern Washington and northern Idaho.

The territory covered by the Association is divided into districts, each district having an appraiser appointed by the President. The duties of the appraisers, as defined by the Association's Constitution and Bylaws are: to receive applications for membership; to inspect all properties offered for an appraisal; to examine carefully all fire hazards, and either approve or reject applicants for membership; to reinspect insured property at least every ten years; to submit reports of all fire losses to the secretary-treasurer; to make a complete report of findings if arson is suspected; to reappraise property if so requested by members; and to take into account storage facilities of gasoline as to whether or not they constitute fire hazards.

### **GROWTH OF THE ASSOCIATION**

The growth of the Association is reflected in the following exhibit compiled from the Association's Annual Statements as of December 31:



<u>Year</u>	Admitted <u>Assets</u>	<u>Liabilities</u>	<u>Surplus</u>
1996	\$1,564,576	\$ -0-	\$1,564,576
1997	1,636,107	-0-	1,636,107
1998	1,759,372	-0-	1,759,372
1999	1,821,964	-0-	1,821,964
2000	1,965,243	-0-	1,965,243

### **LOSS EXPERIENCE**

The following exhibit reflects the underwriting operations of the Association by year, beginning in 1996. The amounts shown were compiled from copies of the Association's annual statements:

<u>Year</u>	Net Premiums <u>Earned</u>	Underwriting Loss <u>Incurred</u>	<u>Ratio</u>	Investment <u>Income</u>	Net <u>Income</u>
1996	\$71,444	\$148,460	(208)%	\$ 82,646	\$ 5,845
1997	63,488	84,188	(133)	92,056	71,531
1998	71,873	41,361	58	92,529	123,265
1999	72,334	91,360	(126)	81,377	62,592
2000	\$68,496	\$ 35,524	52 %	\$109,901	\$143,279

### **ACCOUNTS AND RECORDS**

The Association's accounts and records are maintained on a Generally Accepted Accounting Practices (GAAP) Basis of accounting and are converted to Statutory Accounting Practices (SAP) accrual basis for reporting purposes.

### **SUBSEQUENT EVENTS**

In 2000, the Association had fidelity coverage through Reliance Surety of the Reliance Group Holdings Company (Reliance). Reliance entered into an agreement with the Pennsylvania Insurance Department in 2000 for financial oversight due to unfavorable operating trends. In June 2000,

Travelers Property Casualty (Travelers) acquired the surety, fidelity and related lines of Reliance Surety. Fraternal Benefit Association's policy was assumed by Travelers through the remaining policy period ended December 31, 2000. For year 2001, the Association contracted for a new comparable annually renewable fidelity policy with Travelers.

**FRATERNAL BENEFIT ASSOCIATION**  
**Statement of Assets, Liabilities, Surplus and Other Funds**  
**December 31, 2000**

**Assets**

	<b>Balance Per</b>	<b>Ref</b>	<b>Adjustments</b>	<b>Balance Per</b>
	<b>Company</b>			<b>Exam</b>
Cash	\$200,293			\$200,293
Short term investments	1,638,301			1,638,301
Other invested assets	100,000			100,000
Premiums and agents' balances in course of collection	1,324			1,324
Interest and dividends due or accrued	25,325			25,325
<b>Total assets</b>	<b>1,965,243</b>		<b>0</b>	<b>1,965,243</b>

**Liabilities, surplus and other funds**

Gross paid in and contributed surplus	1,965,243			1,965,243
<b>Total liabilities, surplus and other funds</b>	<b>\$1,965,243</b>		<b>\$0</b>	<b>\$1,965,243</b>

**FRATERNAL BENEFIT ASSOCIATION**  
**Underwriting and Investment Exhibit**  
**For the Year Ended 2000**

	Balance Per Company	Ref	Adjustments	Balance Per Exam
<b>UNDERWRITING INCOME</b>				
Premiums earned	\$68,496			\$68,496
<b>DEDUCTIONS:</b>				
Losses incurred	8,129			8,129
Loss expenses incurred	1,869			1,869
Other underwriting expenses incurred	<u>25,526</u>			<u>25,526</u>
Total underwriting deductions	<u>35,524</u>			<u>35,524</u>
Net underwriting gain (loss)	<u>32,972</u>		<u>0</u>	<u>32,972</u>
<b>INVESTMENT INCOME</b>				
Net investment income earned	<u>109,901</u>			<u>109,901</u>
Net investment gain or (loss)	<u>109,901</u>		<u>0</u>	<u>109,901</u>
<b>OTHER INCOME</b>				
Finance and other service charges not included in premiums	406			406
Total other income	<u>406</u>		<u>0</u>	<u>406</u>
<b>Net income</b>	<u><u>143,279</u></u>		<u><u>0</u></u>	<u><u>143,279</u></u>
<b>CAPITAL AND SURPLUS ACCOUNT</b>				
<b>Capital and surplus, December 31, 1999</b>	<u><u>1,821,964</u></u>			<u><u>1,821,964</u></u>
Net income	<u>143,279</u>			<u>143,279</u>
Net change in capital and surplus for the year	<u>143,279</u>		<u>0</u>	<u>143,279</u>
<b>Capital and surplus, December 31, 2000</b>	<u><u>\$1,965,243</u></u>		<u><u>\$0</u></u>	<u><u>\$1,965,243</u></u>

**FRATERNAL BENEFIT ASSOCIATION**  
**Comparative Statement of Assets, Liabilities, Surplus and Other Funds**  
**For December 31,**

<b>Assets</b>	<b><u>2000</u></b>	<b><u>1999</u></b>
Cash	\$200,293	\$166,446
Short term investments	1,638,301	1,640,124
Other invested assets	100,000	
Premiums and agents' balances in course of collection	1,324	244
Interest and dividends due or accrued	<u>25,325</u>	<u>15,149</u>
<b>Total assets</b>	<b><u><u>1,965,243</u></u></b>	<b><u><u>1,821,963</u></u></b>
 <b>Liabilities, surplus and other funds</b>		
Gross paid in and contributed surplus	1,965,243	1,821,964
 <b>Total liabilities, surplus and other funds</b>	<b><u><u>\$1,965,243</u></u></b>	<b><u><u>\$1,821,964</u></u></b>

**FRATERNAL BENEFIT ASSOCIATION**  
**Comparative Summary of Operations**  
**For the Years Ended December 31,**

	<u>2000</u>	<u>1999</u>
<b>UNDERWRITING INCOME</b>		
Premiums earned	\$68,496	\$72,334
DEDUCTIONS:		
Losses incurred	8,129	60,640
Loss expenses incurred	1,869	3,000
Other underwriting expenses incurred	<u>25,526</u>	<u>27,720</u>
Total underwriting deductions	<u>35,524</u>	<u>91,360</u>
Net underwriting gain (loss)	<u>32,972</u>	<u>(19,026)</u>
<b>INVESTMENT INCOME</b>		
Net investment income earned	<u>109,901</u>	<u>81,377</u>
Net investment gain or (loss)	<u>109,901</u>	<u>81,377</u>
<b>OTHER INCOME</b>		
Finance and other service charges not included in premiums	<u>406</u>	<u>241</u>
Total other income	<u>406</u>	<u>241</u>
<b>Net income</b>	<b><u>143,279</u></b>	<b><u>62,592</u></b>
<b>CAPITAL AND SURPLUS ACCOUNT</b>		
<b>Capital and surplus, Prior year</b>	<b><u>1,821,964</u></b>	<b><u>1,759,372</u></b>
Net income	<u>143,279</u>	<u>62,592</u>
Net change in capital and surplus for the year	<u>143,279</u>	<u>62,592</u>
<b>Capital and surplus, Current year</b>	<b><u>\$1,965,243</u></b>	<b><u>\$1,821,964</u></b>

**FRATERNAL BENEFIT ASSOCIATION**  
**Five Year Reconciliation of Capital and Surplus**  
**For the Years Ended December 31,**

	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
<b>Capital and surplus, December 31, prior year</b>	<b><u>\$1,821,964</u></b>	<b><u>\$1,759,372</u></b>	<b><u>\$1,636,107</u></b>	<b><u>\$1,564,576</u></b>	<b><u>\$1,558,731</u></b>
Net income	<u>143,279</u>	<u>62,592</u>	<u>123,265</u>	<u>71,531</u>	<u>5,845</u>
Net change in capital and surplus for the year	<u>143,279</u>	<u>62,592</u>	<u>123,265</u>	<u>71,531</u>	<u>5,845</u>
<b>Capital and surplus, December 31, current year</b>	<b><u><u>\$1,965,243</u></u></b>	<b><u><u>\$1,821,964</u></u></b>	<b><u><u>\$1,759,372</u></u></b>	<b><u><u>\$1,636,107</u></u></b>	<b><u><u>\$1,564,576</u></u></b>

## NOTES TO THE FINANCIAL STATEMENTS

### Accounting Policies

- A) Basis of presentation  
The financial statements included herein have been prepared in accordance with statutory accounting practices prescribed or permitted by the Washington Insurance Commissioner.
- B) Investments  
Investments are stated on the basis of rules promulgated by the National Association of Insurance Commissioners. Bonds, mortgage loans and short term investments are at amortized value. Preferred and common stocks are valued at market. Preferred or Guaranteed stocks or shares while paying full dividends may be carried at a fixed value in lieu of market value pursuant RCW 48.12.180(2).
- C) Property, Plant and Equipment  
Buildings, land and computer equipment are recorded at cost. Depreciation is computed on a straight line basis over the estimated life depending on the type of asset and statutory regulations.
- D) Underwriting expense  
Underwriting costs such as commissions and general insurance expense are written off in the year incurred and not deferred and amortized against future earnings.
- E) Non-admitted assets  
RCW 48.12.020 defines certain nonallowable assets which are listed as non-admitted in the annual statement. These consist of certain receivables over 90 days past due, prepaid expenses, furnishings, equipment and all electronic data processing equipment not meeting the criteria set forth in RCW 48.12.10. The changes in such assets are reflected as adjustments to net worth.

<b>Cash and Cash Equivalents</b>	<b>\$</b>	<b>200,293</b>
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Cash and cash equivalents as of December 31, 2000 consist of the following:

Bank of Fairfield - Checking Account	\$	66,612
Washington Mutual Bank - Savings Account		60,734
Washington Trust Bank - Liquid Asset Account		<u>72,947</u>
<b>Total</b>	<b>\$</b>	<b><u>200,293</u></b>

All deposits have ninety days or less maturities.



<b>Short Term Investments</b>	<b>\$</b>	<b>1,638,301</b>
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Approximately 83.4% of the Association's assets were held in short term investments as of December 31, 2000. These investments consisted primarily of certificates of deposit and money market certificates. Except as noted in the "Instructions", all were invested in financial institutions with federal deposit insurance and the Association's policy is to maintain all investments in any one bank at one hundred thousand dollars or less.

<b>Direct Premiums Earned</b>	<b>\$</b>	<b>68,496</b>
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In 2000, the Association's direct premiums earned, by state, on fire policies written consisted of the following:

Washington	\$	58,320
Idaho		<u>10,176</u>
<b>Total</b>	<b>\$</b>	<b><u>68,496</u></b>

The Association is not licensed in Idaho but did contact the Idaho Attorney General's Office and the Idaho Insurance Commissioner's Office in 1967 to determine compliance with Idaho statutes. It was the opinion of both Idaho state offices that the Association's best course of action would be to continue operations as a family type organization as they have in the past, and in the future if any successors of their offices wished to pursue another determination, the issue would be addressed at that time. The Correspondence was reviewed as part of our previous examinations and the Association indicated no future determinations were rendered or in process.

## **ACKNOWLEDGMENT**

Acknowledgment is hereby made of the cooperation extended to the examiners by Linda Cupp, Secretary-Treasurer of the Association, during the course of this examination.

In addition, acknowledgment is made of the participation in the work and preparation to this report by Michael V. Jordan, CPA, CFE, MHP, Examiner-in-Charge from the Washington Office of the Insurance Commissioner.

### AFFIDAVIT OF EXAMINER IN CHARGE

STATE OF WASHINGTON )  
 ) ss  
COUNTY OF KING )

Michael V. Jordan, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Fraternal Beneficial Association was performed in a manner consistent with the standards and procedures required or prescribed by the Washington Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Michael V. Jordan, CPA, CFE, MHP  
Examiner-in-charge  
State of Washington

Subscribed and sworn to before me this 8th day of March, 2002.

Notary Public in and for the  
State of Washington, residing  
at Olympia.